



Hedge against inflation.

Why the infrastructure sector could benefit your portfolio.



Why Infrastructure Plays Are Likely To Be Resilient In The Coming Years

Description

The markets have spoken – people are worried about [inflation hitting its highest in 40 years](#) and with little signs of abating anytime soon; while [shrinking GDP is raising the odds of a recession in the near term](#). But for income investors looking to generate stable income, infrastructure assets aligned to generational growth themes may potentially offer a boost to your portfolio. These not only have multiple tailwinds, but also government mandates pushing their growth forward, making them a suitable asset class for risk-adverse investors. Here's a few ways you can ride on it.

Will the current market volatility continue?

The road ahead for equities may not be as smooth-sailing as it was in the last decade.

If we zoom out into the longer-term chart of the S&P 500, the last decade up till 2021 was marked by a steady, almost relentless increase. Equities performed superbly well during this period.

Market Summary > S&P 500

4,280.15

+4,167.13 (3,687.07%) ↑ all time

12 Aug, 6:27 pm GMT-4 • Disclaimer

1D | 5D | 1M | 6M | YTD | 1Y | 5Y | Max



Source: Screenshot from Google. Figures are in USD.

But when I looked back into earlier decades, I realized this was not always the case:

Years	Start	End
2009 - 2021	931.8	4,766.1
2010 - 2020	1,132.99	3,756.0
2000 - 2010	1,455.22	1,257.6
1990 - 2000	359.69	1,320.2
1980 - 1990	105.76	330.22

Source: Author's own compilation. Start and end numbers are in USD.

What stands out to me is how **we've just emerged out from a period of unprecedented gains**, likely fuelled by the generous liquidity and loose monetary policy of that era.

Now, with this liquidity being taken out of the system, we should be prepared for slower growth in the decade ahead. What's more, combined with [recession fears](#), [global political tensions](#), [inflation](#) and [slowing growth](#), we can expect markets to be choppy for a while longer.

For investors looking for growth without the volatility, infrastructural plays can indeed be a good hedge against inflation and future uncertainty. While global equities, bonds and real estate posted double-digit losses in the first 5 months of this year, in contrast, global core infrastructure rose 2.52% during this same period.

Particularly **for income investors, you'd want to avoid investing in any assets that will face difficulties in generating enough income to offset inflation.**

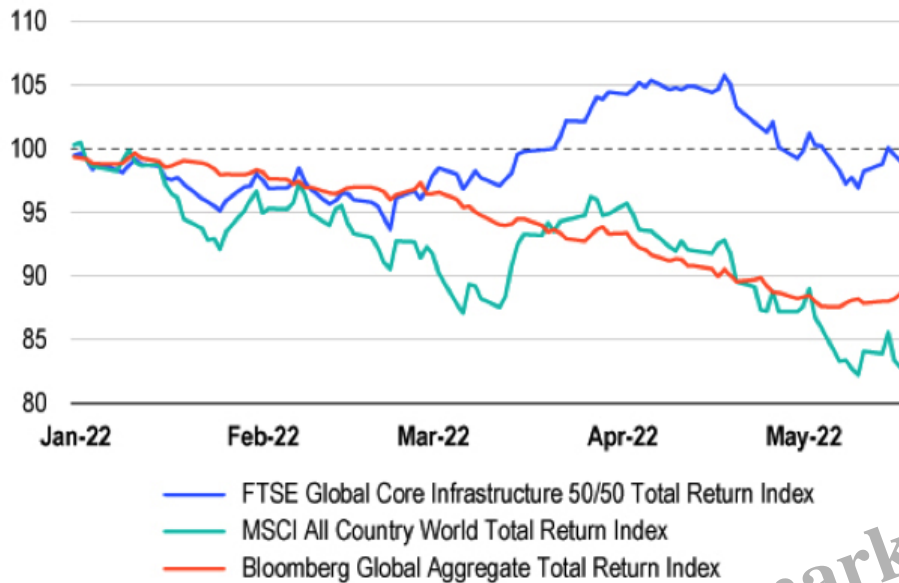
Infrastructure – a reliable hedge against market downturns

A look back into history shows the same trend – [according to research by Franklin Templeton](#), **out of the 21 market sell-off episodes since 2005, global listed infrastructure stocks outperformed global equities 67% of the time.**

Hence, for investors who wish to take on comparatively lower risk while still seeking growth, you'll be pleased to note that the infrastructure sector is hardly correlated to the performance of bonds and equities; in fact, it has outperformed despite challenging market conditions.

Strong outperformance of infrastructure versus global equities and global bonds

(Rebased 31 Dec 21 = 100)



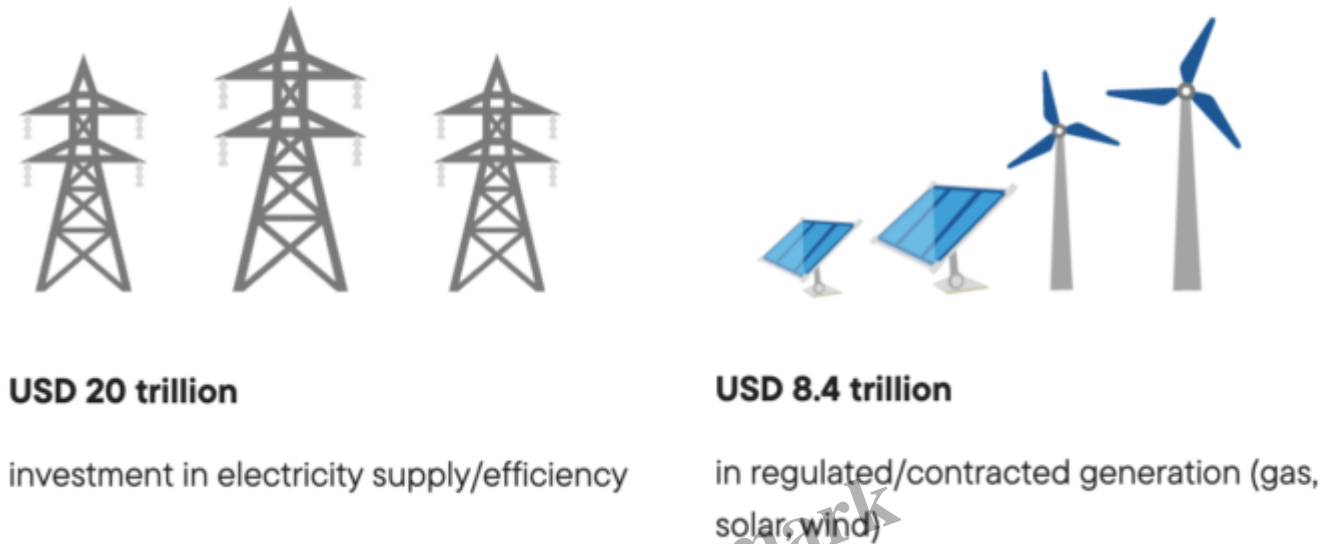
Source: [Franklin Templeton](#)

Why the outperformance? Well, for a start, many of these infrastructure provide essential services that are vital for modern society to continue functioning. For instance,

- Utilities – people still use water, electricity and gas every day
- Communication – with growing demand for cloud and data, including the shift towards 5G, infrastructure providers such as cellular towers have to grow to keep up
- Transport – shipping, e-commerce logistics and travel add to increased transport infrastructure needs
- Energy – midstream pipelines and contracted renewables are benefiting from the push towards greater carbon capture, storage and renewable energy

In the United States, Congress has already passed Biden's \$1 trillion infrastructure bill, otherwise known as the Bipartisan Infrastructure Law to rebuild America's roads, bridges and rails, expand access to clean drinking water. But the need for infrastructure upgrades is not limited to just the US alone, but rather, global spending is estimated to hit an all-time high:

Estimated Global Infrastructure Spending 2018-2040²



Source: [Franklin Templeton](#)

In developed economies, an increased need for facilities upgrades, capacity boost, maintenance and [the latest shift towards decarbonization will necessitate higher infrastructure expenditure.](#)

For emerging markets, population growth and urbanisation calls for expansion of infrastructural support, such as in countries like [Brazil](#) and [India](#), where [the government is pushing for almost double of its current capacity to be built in the next few years.](#)

Some examples of listed infrastructure equities that are working on meeting these needs include:

- National Grid PLC – delivers electricity and gas in the UK and US.
- Iberdrola SA – a global energy company (third electricity utility by market cap) and the second biggest producer of wind power.
- Atlas Arteria Ltd – a global developer and operator of private toll roads in France, Germany and the United States.
- Clearway Energy Inc – one of the largest renewable energy owners in the US with over 5,000 net MW of installed wind and solar generation projects.

Distinguishing between infrastructural assets

Specifically, we can group infrastructure plays into 2 main types of assets:



Regulated Assets

- Regulated with stable cashflows, high income and low GDP exposure
- Examples: poles, wires, pipes.



User Pays Assets

- Growth assets with lower income but leveraged to GDP, and affected by consumer demand
- Examples: roads, rail, ports, airports etc.

Source: [Franklin Templeton](#)

Regulated assets tend to be more defensive in nature due to the stable and inelastic demand for its services. On the other hand, companies with user-pay assets take on volumes risk – the more people use these assets, the more revenue they generate.

This explains why telecom operators have been building more cell towers in certain countries in recent years, as the demand for mobile data grows.

Decarbonisation and renewables are strong tailwinds

Another plus for this sector is also [the continued decarbonisation efforts and the demand for more green infrastructure](#). Companies who can meet and support such demand, have a longer pathway and can provide a stable, growing profile for investors.

[The International Energy Agency \(IEA\) projects renewable energy will account for nearly 90% of electricity generation by 2050](#). IEA also expects spending on green electricity systems to nearly triple by 2030 for the world to be on track to achieve net zero carbon emissions by then.

This shows that in our net-zero future, 2 trends stand out:

- Carbon-free electricity will soon become the dominant choice of energy carrier
- Renewable energy technologies like solar, hydro and wind will become critical for power generation.

Going green used to be an option, but today it has become a clear mandate (especially if we wish to avert an outright climate disaster).

Income investors need to look for dividends that are independent from the economic cycle

The worst nightmare for most income investors is a scenario where you have lesser dividends combined with falling stock prices.

For most stocks, dividends are typically paid out of the company's revenues or profits. In difficult periods, the dividends paid may fall; we saw this happen during the pandemic where many companies cut or halted their dividend payouts.

If you're trying to protect your dividend base, infrastructure companies with their dividend payouts **linked to the asset bases rather than the economic cycle** are attractive.

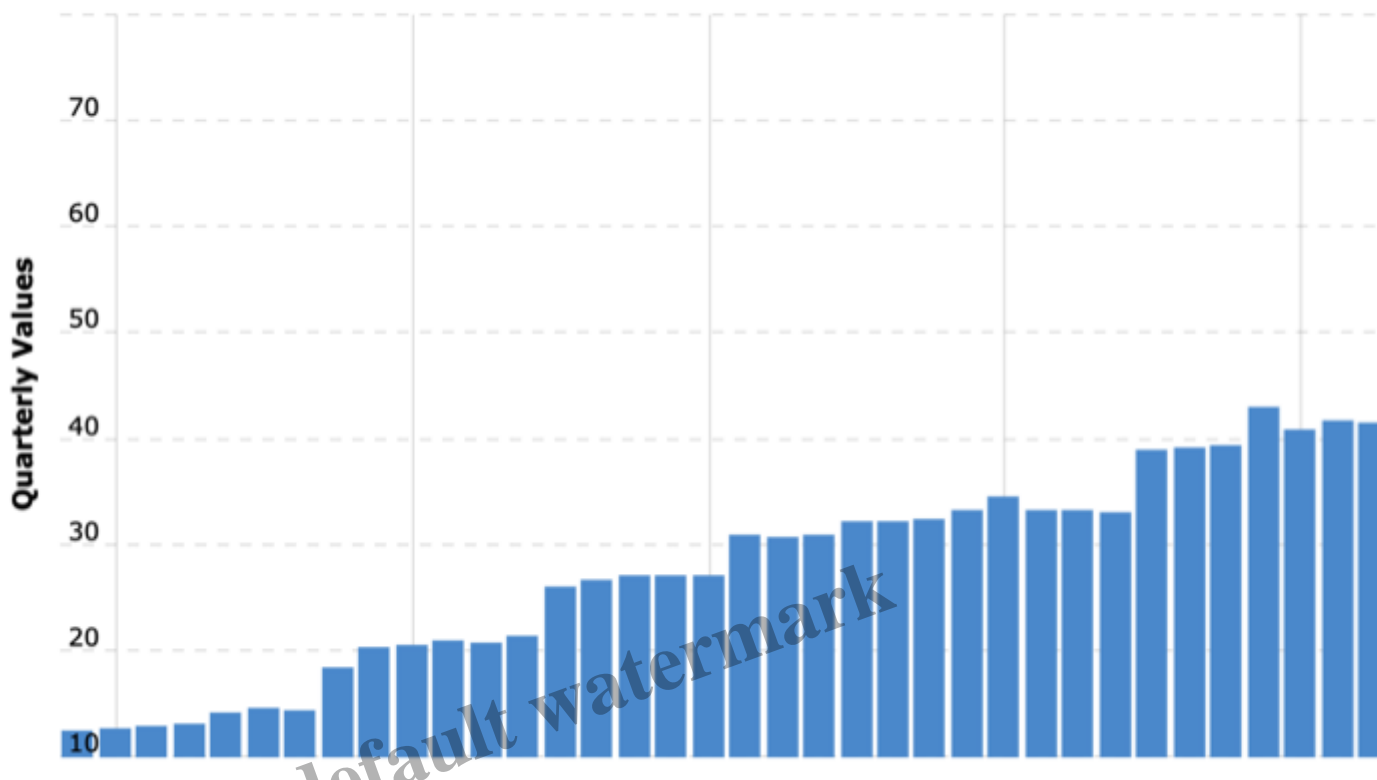
Historically, many companies that grow their infrastructure asset base usually go on to pay higher dividends. As an example, let's take a look at American Tower (a worldwide operator of cell towers)'s dividend history and asset growth:



American Tower dividend growth

From: 01/31/2012 To: 07/01/2022

Zoom: 1Y



American Tower asset growth, measured in USD billions.
Source: Author's screenshots from Macrotrends on 18 August 2022.

TLDR: Infrastructure is a powerful hedge against inflation

When we invest, we want to invest in assets that not only offer a margin of safety, but also have strong growth prospects for the future.

Who might benefit from the current regulatory mandates for significant decarbonisation efforts, shifting public spending priorities towards greener infrastructure, and the continued urbanisation of populations?

Investors who can identify companies well-placed to ride these long-term secular growth trends will benefit.

If you haven't already incorporated infrastructure assets into your portfolio, now may be the time to start looking at them.

[Get ideas from fund managers investing into infrastructure assets here.](#)

P.S. Enjoyed this read? Check out this article to learn about another strategy – [the multi-asset income strategy](#) – as another potential approach you can adopt.

Sponsored Message

Like most sectors, some companies are better positioned than others to benefit from the recovery. Judicious stock selection will require scrutinising the quality of an infrastructure company. Or you can outsource that to the professionals at Franklin Templeton, via our **Legg Mason Clearbridge Global Infrastructure Income Fund**.

[Check out the fund here.](#)



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